

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

PERIODIC REPORTING  
(PROPOSAL FOUR)

Docket No. RM2016-12

REPLY COMMENTS OF THE  
UNITED STATES POSTAL SERVICE  
(November 14, 2016)

Order No. 3546 (October 4, 2016) reset October 17, 2016 as the deadline for initial comments in this proceeding, and October 31 as the deadline for reply comments. Order No. 3586 (October 26, 2016) subsequently reset the deadline for reply comments to November 14, 2016. Other than very brief comments filed by the Parcel Shippers Association on October 17 supporting the proposal conceptually, more substantial initial comments were submitted on that date by the Public Representative and UPS. The United States Postal Service hereby responds to the initial comments of those two parties regarding Proposal Four.

United Parcel Service (UPS)

The Comments of UPS profess to agree with the Commission and the Postal Service that the current assumption of a variability of purchased highway transportation capacity with respect to mail volume of 100 percent is merely a placeholder, and should be replaced when empirical analysis provides a more refined percentage figure. UPS Comments at 20. UPS nonetheless maintains that none of the analysis supporting Proposal Four provides an adequate basis to supplant the placeholder assumption of direct proportionality (i.e., an assumed variability of 100 percent). The criticisms that UPS offers, however, do not withstand scrutiny.

One primary component of the UPS position is that the data used by the Postal Service to empirically test (and reject) the assumption of direct proportionality, and to derive alternative variabilities, are inadequate to the task. That contention is fully addressed and refuted in the Report prepared by Professor Bradley to accompany these reply comments. Professor Bradley's Report is attached to this document electronically. He shows that the UPS criticisms of the TRACS data are based on conceptual misunderstandings, incorrect and misleading "tests" of the accuracy of TRACS data, computational errors, and invalid inferences based on misdirected comparisons. Bradley Reply Report at 1-17. In instance after instance, Professor Bradley demonstrates that, when appropriate analysis is applied to carefully examine what UPS claims are the implications of its *ad hoc* observations, the evidence instead refutes those implications. Professor Bradley concludes that the concerns about the suitability of TRACS data expressed by UPS are overstated, and provide no legitimate basis to reject the Proposal Four analysis.

Professor Bradley also addresses a series of unfounded claims in the Brattle Group Report about the model specification. Bradley Reply Report at 18-23. He identifies misunderstandings on topics as basic as the time-series nature of the data, and the important distinction between the level at which the analysis is conducted, versus the level at which the data are collected. He explains why "peak" volume cannot simply be assumed to be the sole determinant of capacity, when critical real-life service considerations must be taken into account, and when "peak" volume can be handled through extra trips on routinely heavy days rather than by driving up capacity every day of every week. Professor Bradley puts to the test the claim that the Postal Service's

variability analysis is “implausibly” premised on an assumption that there is daily adjustment of capacity to volume. He conducted an additional analysis excluding any implicit assumption of daily adjustments of capacity to volume by aggregating the quarterly data across all days of the week, rather than aggregating the quarterly data by day of week. His results refute the claim that, without the “implausible” assumption, the placeholder 100 percent variability would be confirmed, and his results instead show that the Proposal Four variability estimates would continue to fall within the same range. *Id.* at 21-22.

Similarly, Professor Bradley explains the folly of assertions that the variabilities he has estimated for the highway transportation network as it currently operates (with an average of 40 percent capacity) would necessarily be the same for an entirely different and improbable network (with, for example, average capacities approaching 100 percent). Bradley Reply Report at 22-23. Equally nonsensical are assertions that the validity of his estimated variabilities is dependent on the Postal Service willingness to eschew capacity reductions in response to persistent volume declines. The Postal Service can, and does, rationalize its network as volume declines, but cannot do so directly proportionally because of other factors such as service constraints. *Id.* UPS is entirely off base to suggest that variabilities of the magnitudes estimated in Proposal Four would require “irrational” behavior by precluding prudent network rationalization in the face of volume declines.

Potential bias is another allegation by UPS that Professor Bradley explains to be unfounded. Bradley Reply Report at 24-33. For example, rather than stopping (as the Brattle Group Report does) at an assertion that measurement error could be causing

bias, Professor Bradley uses instrumental variables to put that concern to the test. His results reveal no basis to reject Proposal Four because of measurement error bias. *Id.* at 24-29. In contrast to attempting to actually test for bias, UPS instead constructs a series of models in which it systematically throws out more and more lower-utilization observations. Professor Bradley explains why, rather than suggesting bias, this exercise simply confirms that if the Postal Service had a different purchased highway transportation network than it actually has, then the estimated variability would be different. *Id.* at 29-31. In essence, UPS seeks to ignore all the factors that cause the Postal Service's actual network to have the actually observed utilization rates, and instead creates a network of its own imagination in which volume considerations overwhelmingly predominate and much higher utilization rates would, naturally, be associated with higher variabilities. Recognizing what amounts to this tautology embedded in the UPS exercise in no way suggests bias in the means by which the Postal Service has estimated variability with respect to its existing highway transportation network. The same flaw undermines the additional simulation exercise regarding its "synthetic" highway network. *Id.* at 31-33.

In the course of advocating the rejection of Proposal Four, UPS also raises an essentially unrelated issue – the treatment of costs of highway contracts operating specifically during the holiday season of the year. UPS Comments at 9-11. The issue is unrelated to Proposal Four because the arguments upon which UPS relies to question the current treatment of those holiday contracts have nothing to do with the alleged infirmities of the Proposal Four empirical analysis. Instead, UPS suggests that the very nature of those contracts requires application of an overall variability of 100

percent, assuming direct proportionality of costs with volume. *Id.* at 3, 10. What UPS is advocating, which is perhaps more clear in the Brattle Group Report (at 19-20) than in the UPS Comments document, is that the assumed overall variability of 100 percent currently applied to exceptional contracts should apply to Christmas contracts as well. Such a suggestion could clearly have been advanced entirely independent of Proposal Four, which is presumably why the Brattle Group Report (at 18) labels its discussion of the matter as a “digression.” Moreover, the Commission itself appears not to credit this suggestion as intrinsic to Proposal Four, because Order No. 3586 denied the Postal Service’s request to submit information requests to UPS specifically because the Commission takes the view that UPS critiqued Proposal Four, but offered no new alternatives. Order No. 3586 (October 26 2016) at 2.

Significantly, the UPS Comments on this topic are patently self-contradictory. On pages 3 and 10, UPS asserts that these costs are inherently driven by changes in the volume of products moving through the system at critical times of the year. Yet on page 20, UPS inconsistently urges that these costs be treated as “product specific” (to the group of competitive products). The very concept of “product specific” cost is intended to handle costs which do not vary with the volume of the products in question. Moreover, UPS plays fast and loose with the identity of the products it claims are driving these contracts. UPS (page 10) cites “parcel delivery” as the culprit, but then immediately switches to an assertion that competitive products are to blame. Yet “parcels” comprise both competitive and market dominant products. Perhaps more critically, even the quotation of the former PMG presented by UPS in footnote 36 on page 11 makes clear that cards and letters, as well as parcels, are surging at that time

of year.<sup>1</sup> UPS has tried to patch together support for its obviously ends-driven suggestion to treat all of these costs as “product specific” to the group of competitive products, but the attempt clearly fails.

The Postal Service acknowledges some validity to the notion that seasonal contracts, like exceptional service contracts, are likely to be more directly related to changes in volume, or the expectation of changes in volume, than are regular contracts. Accordingly, the costs of such contracts, like exception service contracts, could perhaps be treated as more or even fully attributable. The Postal Service, however, strongly disagrees with the further contention that such costs should also be distributed exclusively to competitive products. To the extent that it may be true that parcel products are playing an increasingly more important role in creating the need for these types of contracts, there is no reason to think that those circumstances are not already reflected in the overall highway distribution factors for Quarter One. The Brattle Group Report concedes that the seasonal contract costs are concentrated in Quarter One (page 18), and that separate distribution factors are developed by TRACS for each quarter (page 20). But the “intuitive notion” cited by the Brattle Group Report (page 20) that parcels alone cause the seasonal volume spike cannot logically be equated (even if it were true, which it is not) with the further supposition that parcels alone travel on Christmas routes, while all other products are relegated to the regular routes during that time of year. Instead, it is much more reasonable to conclude that whatever spikes in volume are being transported on Christmas routes are likewise concurrently showing up on regular routes, and thus are appropriately captured by the quarterly distribution

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<sup>1</sup> And while not mentioned in the footnote, catalog volume is also relatively high during this period of the year.

factors from TRACS.

Fundamentally, the treatment of Christmas routes is outside the scope of Proposal Four. Rather than attempt to propose alternative analysis to Proposal Four to measure the variability of capacity with respect to volume, UPS instead falls back on an (erroneous) assertion that the data are insufficient to support any deviation from the placeholder assumption of direct proportionality. It is thus disingenuous for UPS to nonetheless expect the Commission to accept as adequate the entirely speculative basis UPS has proffered to consider the costs of Christmas routes more related to competitive products than suggested by the sampling of regular routes run during the same times of year. Proposal Four is based on valid empirical analysis, while the UPS contentions regarding Christmas routes are nothing more than unsupported conjecture.

#### Public Representative

Unlike UPS, the Public Representative proposes specific modifications to the Proposal Four models that would result in different volume-to-capacity variabilities. After all of his analytical effort, however, the Public Representative then curiously recommends, like UPS, that those variabilities not be considered improvements over the current placeholder assumption of 100 percent. Professor Bradley first addresses the modifications proposed by the Public Representative, and then explains why the reasons stated for refusing to apply those variabilities are misplaced. Bradley Reply Report at 33-39.

There are, in fact, three components of the Public Representative's analysis. The first, as identified above, involves possible refinements to the Proposal Four models. As Professor Bradley explains, the suggestion to add back zero-volume test

observations, while perhaps not unreasonable, would not alter the conclusion that variability should not be assumed to be 100 percent, and in fact would reduce estimated variability relative to what is recommended in Proposal Four. Bradley Reply Comments at 34. In contrast, the rationales for other suggestions (to change the model specification slightly and to add additional variables) are not clearly articulated, and their implementation would produce no discernible pattern in the estimated results. *Id.* at 34-35.

A second component of the Public Representative's arguments relates to the interaction between the established capacity-to-cost variabilities, and the proposed volume-to-capacity variabilities. For example, he postulates that bias could arise from differences in "structure" between the TCSS data were used to estimate the former set of variabilities and the TRACS data used to estimate the latter set. Professor Bradley meticulously shows those concerns to be unfounded. *Id.* at 35-37. Professor Bradley also explains why the Public Representative's concern regarding different methods of measuring truck capacity in TCSS and TRACS is likewise based on a misunderstanding of the facts. *Id.* at 37. Fundamentally, the Public Representative offers no cogent basis to decline to combine the established capacity-to-cost variabilities and the proposed volume-to-capacity variabilities in the manner contemplated by Proposal Four.

As Professor Bradley notes, the third component of the Public Representative's comments raises issues relating directly to the established capacity-to-cost variability, and are thus extraneous to Proposal Four. The first issue raised regarding the current methodology is endogeneity. Professor Bradley explains why the allegations made by the Public Representative on this topic are rooted in a conceptual misunderstanding of



the issue he has raised. *Id.* at 38. The second issue raised is the possibility of omitted variables. As Professor Bradley discusses, however, the models in question have been scrutinized previously in numerous dockets, and no relevant omitted variables have been identified. Moreover, the Public Representative never clearly articulates what these omitted variables might be, and what the effects could be from their omission. *Id.* at 39. Professor Bradley, however, does identify misunderstandings within the Public Representative's discussion of this issue which have led to his unfounded allegations. Even if the review of Proposal Four were an appropriate forum to raise the matter (which it is not), there is no basis for contending that omitted variables undermine the established capacity-to-cost variability estimates. *Id.*

### Conclusion

The recognition that the current assumption of a volume-to-capacity variability of 100 percent is only a placeholder that merits empirical examination goes back decades. In Proposal Four, the Postal Service has used the best available data to test that assumption and, having found the assumption to be at odds with such data, to provide better empirical estimates to replace it. Proposal Four represents the results of careful and deliberate research which harmonizes the costing treatment of purchased highway transportation costs with the real-world operation of a massive and sophisticated transportation network balancing changes in mail volume with routine service considerations, universal service obligations, and retail, mail processing, and delivery network constraints. The Proposal Four variability equations were subject to a wide range of model specifications and data constructions. What emerges clearly from review of the proposal and the comments in response, however, is that no credible

variation of the models supports the assumption of 100 percent variability.

Nonetheless, Proposal Four reflects a conservative approach, in which choices between reasonable modeling alternatives were deliberately made to shy away from the procedures that generated lower variability estimates. Consequently, and as essentially confirmed by the Public Representative's analysis, the Postal Service submits that the adoption of Proposal Four presents little risk of understating the Postal Service's actual ability to adjust capacity to changes in the volume of the mail requiring highway transportation. In contrast, preservation of the status quo assumption of an unimpeded ability to directly and proportionally adjust capacity to such volume changes certainly would continue to materially overstate that adjustment capability. Proposal Four should be adopted.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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